United States Court of Appeals

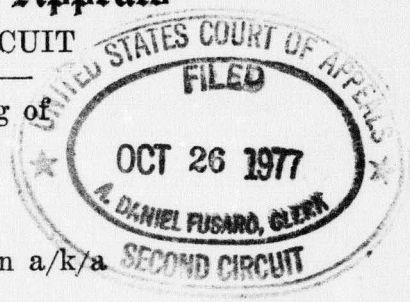
for the Second Circuit

BRIEF FOR APPELLANT

77-6150

To be argued by
ALLAN E. KIRSTEIN

United States Court of Appeals
FOR THE SECOND CIRCUIT



Matter of the Accounting of

ABRAHAM D. LEVY
As Administrator
of
the Estate of Charles Brown a/k/a
Charles W. Brown, Dec.

STATE OF NEW YORK
Appellant-Respondent

UNITED STATES OF AMERICA
Appellee-Petitioner

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

APPELLANT'S BRIEF

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Matter of the Accounting of

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STATE OF NEW YORK
Appellant-Respondent

UNITED STATES OF AMERICA
Appellee-Petitioner

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

APPELLANT'S BRIEF

Preliminary Statement

This is an appeal from an opinion and judgment of the United States District Court for the Southern District (CANNELLA, J.) entered on August 8, 1977 ruling that non-V.A. derived assets passing from a decedent's estate to the custody of the United States as trustee by operation of law (38 U.S.C. 5220[a]) are not subject to estate tax

by the State of New York. The court's opinion is not yet reported. Respondent-appellant's notice of appeal was filed on September 6, 1977.

Questions Presented

1. Was Congress without power to declare an escheat under 38 U.S.C. 5220(a) as to property which was not derived from Federal benefits?

2. Is property passing to the United States under 38 U.S.C. 5220 subject to New York estate tax under Article 26 of the New York Tax Law?

3. Are non-V.A. derived assets passing to the United States Government pursuant to 38 U.S.C. 5220(a) deductible from the decedent's gross estate?

4. Should the United States District Court have entertained jurisdiction in this matter?

Statement of the Facts

Charles W. Brown, the decedent herein, died at age 75 March 5, 1973 in the Bronx V.A. Hospital after a 4 day illness. The decedent was a retired N.Y.C. teacher who, it is indicated, was a veteran of the United States Armed Forces.

Since the decedent died intestate leaving no spouse, heirs or next-of-kin surviving, the Public Administrator of Bronx County was appointed administrator of the estate of the decedent. After being duly qualified, he marshalled the assets,* paid the funeral expenses of the decedent and the expenses of administrator.

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* See letter of Abraham D. Levy, as administrator dated 10/13/77 stating that deledent's assets show no indication of being derived from V.A. benefits (Appendix p. 8a).

The administrator then petitioned the Surrogate's Court, Bronx County, for an order fixing tax on the deceased veteran's estate pursuant to Article 26 of the Tax Law. The decedent's gross estate was $72,233.00, none of which was realty. Deductions of $3,543.00 for funeral and administration expenses left a New York taxable estate of $68,690.00. The Surrogate, by order dated and entered April 4, 1974, fixed the New York net estate tax at $1,459.38. The administrator paid the tax and four days later, on April 8, 1974, brought the captioned proceeding in the Surrogate's Court, Bronx County. (The administrator also filed a United States estate tax return and paid the federal estate tax as determined by the Internal Revenue Service.)

The Surrogate adjourned the accounting proceeding 4/26/74 (Schedule "G" showed the United States claimed the "net proceedings pursuant to Section 5220. . . .") and ordered a citation issued to the United States as an interested party.

The United States filed objections to that part of the final accounting showing that New York State estate taxes were paid on that part of the decedent's estate ($7,066.76) which the United States claims was immediately vested in it on the death of the deceased veteran in a V.A. facility. On May 22, 1974, the United States filed a notice of removal in the Surrogate's Court to transfer the accounting proceedings to the United States District Court for the Southern District of New York and the United States also moved for summary judgment on the merits.*

By stipulation between the State of New York and the United States, the State of New York filed a supplemental affidavit challenging the constitutionality of 38 U.S.C. § 5220(a) with respect to escheat of non-V.A. derived assets of decedent.

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* Record on Appeal, Doc. #2, Exh. 2.

On July 22, 1977, Hon. John M. Cannella, District Judge, filed his opinion granting the United States motion for summary judgment holding that assets passing to the United States pursuant to 38 U.S.C. 5220(a) were not includable in the decedent's gross estate and hence not subject to the New York estate tax. Judge Cannella did not address his opinion to the issue of the constitutionality of 38 U.S.C. 5220(a).

On September 6, 1977, the State of New York filed its notice of appeal to this Court.

Relevant Statutes

Title 38 United States Code, Veterans Benefits.

38 U.S.C. § 5220 Vesting of property left by decedents

(a) Whenever any veteran (admitted as a veteran) shall die while a member or patient in any facility, or any hospital while being furnished care or treatment therein by the Veterans' Administration, and shall not leave surviving him any spouse, next-of-kin, or heirs entitled, under the laws of his domicile, to his personal property as to which he dies intestate, all such property, including money and choses in action, owned by him at the time of death and not disposed of by will or otherwise, shall immediately vest in and become the property of the United States as trustee for the sole use and benefit of the General Post Fund (hereafter in this subchapter referred to as the "Fund"), a trust fund prescribed by section 725s(a) (45) of title 31.

(b) The provisions of subsection (a) are conditions precedent to the initial, and also to the further furnishing of care or treatment by the Veterans' Administration in a facility or hospital. The acceptance and the continued acceptance of care or treatment by any veteran (admitted as a veteran to a Veterans' Admin-

istration facility or hospital) shall constitute an acceptance of the provisions and conditions of this subchapter and have the effect of an assignment, effective at his death, of such assets in accordance with and subject to the provisions of this subchapter and regulations issued in accordance with this subchapter.

New York Tax Law, Article 26—Estate Tax

§ 955. Resident's New York estate tax deductions

(a) General—The New York estate tax deductions for the estate of a deceased resident mean the deductions from his federal gross estate allowable in determining his federal taxable estate under the internal revenue code (whether or not a federal estate tax return is required to be filed), exclusive of the sixty-thousand dollar exemption under section two thousand fifty-two of the internal revenue code. . . .

POINT I

Congress was without power to declare an escheat under 38 U.S.C. § 5220 as to property which was not derived from federal benefits.

None of the decedent's assets were derived from V.A. benefits. Yet, under 38 U.S.C. § 5220(a) the United States government claims them pursuant to this federal vesting statute.

The United States Supreme Court has held in *Hamilton* v. *Brown,* 161 U.S. 256, 263 (1896) that there is no federal law of escheat, this being an area which has been left to the states.

The Supreme Court of the United States further pointed out in *Irving Trust Co.* v. *Day,* 314 U.S. 556, 562 (1942) that each State of the United States is given plenary power with respect to the laws of descent and distribution as to property within its jurisdiction.

5220(a) with respect to non-V.A. assets is a classical escheat statute in that it permits the federal government to take property merely because the decedent died at a federal V.A. facility. The property in question was not derived from the federal government. The State of New York has challenged the constitutionality of 5200(a) in the Supplemental Affidavit of Assistant Attorney General Irwin M. Strum dated April 15, 1976 (see Record on Appeal, Doc. #10).

The federal government relies upon *United States* v. *Oregon,* 366 U.S. 643 (1960), pet. for rehearing denied, 368 U.S. 870, which case involved a deceased veteran who left an estate consisting of assets inherited from the estate of his predeceased brother and a small amount of unexpended veteran pension funds.

The State of Oregon contested only those assets which were inherited from the decedent's brother and would otherwise pass to the United States government under a statute which is now 38 U.S.C. 5220(a).

The United States had appealed from the Oregon Supreme Court's affirmance of the decree of the Oregon Probate Court escheating to the State of Oregon that portion of the estate the decedent inherited from the estate of his predeceased brother ($12,755.67). The United States claimed this windfall inheritance pursuant to the General Post Fund statute (now 38 U.S.C. §5220[a]).

> "Here, however, the government reaches not for the residue of pension funds, but for property which came to Warpouske by inheritance." (*State Land Board* v. *United States,* 222 Or. 45, 59).

On appeal to the United States Supreme Court, sub nom. *United States* v. *Oregon,* the Oregon Supreme Court was reversed and the United States was allowed to take the inheritance from the estate of Adam's predeceased brother. (*United States* v. *Oregon,* 366 U.S. at 950).

Mr. Justice Douglas, in his dissenting opinion, concurred in by Mr. Justice Whittaker, in *Oregon* eloquently espouses the position of the State of New York:

> "I do not see how this decedent's estate can constitutionally pass to the United States. The succession of real and personal property is traditionally a state matter under our federal system . . .
>
> "We deal here, however, with an inheritance that the incompetent veteran received from his brother—an estate worth about $13,000 . . . Oregon has provided how the property of one who dies intestate and without heirs shall be distributed; and that is its constitutional right under the Tenth Amendment. Never before has a federal law governing the property of one dying intestate been allowed to overrule a state law."
>
> (366 U.S. at 649, 650).

However, a more recent decision by the Supreme Court of the United States supports New York State's contention that 38 U.S.C. 5220(a) is unconstitutional with the respect to non-V.A. derived assets.

National League of Cities v. *Usery*, 426 U.S. 533 (1976) holds:

> "But we have reaffirmed today that the States as States stand on a quite different footing from an individual or a corporation when challenging the exercise of Congress' power to regulate commerce. We think that dicta from *United States* v. *California*, [297 U.S. 175], simply wrong. Congress may not exercise that power so as to force directly upon the States its choices as to how essential decisions regarding the conduct of integral governmental functions are to be made. We agree that such assertions of power, if unchecked, would indeed, *as Mr. Justice Douglas cautioned in his dissent in Wirtz* [*392 U.S. 183*], *allow 'the*

> *National Government* [*to*] *devour the essentials of state sovereignty.' 392 U.S. at 205,* and would therefore transgress the bounds of the authority granted Congress. . . . While there are obvious differences between the schools and hospitals involved in *Wirtz,* and the fire and police departments affected here, each provides an integral portion of those governmental services which the States and their politial subdivisions here traditionally afforded their citizens. We are therefore persuaded that *Wirtz* must be overruled." (*National Leage of Cities* v. *Usery,* 426 U.S. at 854, 855) (emphasis added).

Concededly, fire and police departments are integral part of state services. However, the right of a state to provide for the intestate distribution of one of its residents, including a state escheat law, if it so deems, is nonetheless essential, especially in light of the financial condition of many of our states today. The erosion of any of these essential rights afforded to the states by our Constitution can only hasten the time when the states will hand over all essential functions to the United States Government. Thus, the Supreme Court, since *Oregon,* has inferentially adopted the dissent of Mr. Justice Douglas, in the *Oregon* case.

The United States has alternatively argued that the decedent signed an application on a prior admission to the V.A. hospital by which he agreed that all of his personal property not otherwise disposed of would pass to the United States as trustee, in return for medical care. However, when the decedent re-entered the hospital four days before his death, the application was never signed and therefore no contractual issue is presented in the case at bar.

Even assuming *arguendo* that the decedent had signed a form allowing the federal government to claim all of his property, the use of such form by the federal government

constitutes an overreaching. Mr. Brown was over 65 and entitled to free V.A. Hospital care as a veteran pursuant to Section 610(a)(4) of Title 38, U.S.C. Therefore, to require him to agree to an escheat as a condition for such hospital services cannot be condoned or justified.

Thus, the federal government may only justifiably make claim to the non-V.A. derived assets of the decedent solely through 38 U.S.C. 5220(a) which is unconstitutional and therefore the federal claim must fail.

POINT II

Property passing to the United States under 38 U.S.C. 5220 is subject to estate tax under Article 26 of the New York Tax Law.

The Court below ruled that the decedent's property passes by operation of law, and not by transfer. Hence, any taxation of such property would be "state taxation of federal property, a result prohibited by *McCulloch* v. *Maryland,* 4 Wheat. 316, 4 L. Ed. 579 (1819)."

This is not the fact. The New York estate tax is imposed by order of the Surrogate's Court on the right or privilege of the decedent to transfer property he owned until his death. And Section 952 of the Tax Law imposes an estate tax on the "transfer of the New York taxable estate of every deceased individual who at his death was a resident of New York State."

In *Matter of Merriam,* 141 N.Y. 479 (1894), the imposition of a state inheritance tax upon the right of a decedent to bequeath personal property to the United States was deemed proper.

> ". . . Assuming this legacy vested in the United States at the moment of testator's death, yet in contemplation of law the tax was fixed on the succession at the same instant of time. This is not a tax imposed

> by the state on the property of the United States. The property that vests in the United States under this will is the net amount of its legacy after the succession tax is paid . . ." (141 N.Y. at 484)

Not only did the United States Supreme Court affirm (*sub. nom. United States* v. *Perkins*, 163 U.S. 625, 1896) but 55 years later it asserted the right of Illinois to impose a death tax on a bequest to a state instrumentality merely citing *Perkins* as authority. *Bd. of Regents of Univ. of Wisc.* v. *Ill.*, 339 U.S. 906 (1950).

To the same effect see *Chase National Bank* v. *United States*, 278 U.S. 327 (1929):

> ". . . we think the power to tax the privilege of transfer at death cannot be controlled by the mere choice of the formalities which may attend the donor's bestowal of benefits on another at death, or of the particular method by which his purpose is effected, so long as he retains control over those benefits with power to direct their future enjoyment until his death." (*supra*, at 338)

In *United States Trust Company* v. *Helvering*, 307 U.S. 571 (1939), the United States Supreme Court held that the proceeds of a War Risk Insurance Policy on the life of a deceased veteran payable to a named beneficiary were includible in his gross estate under a Federal estate tax law and the Commissioner of Internal Revenue properly included same in measuring the tax assessed on the estate.

The trust company-petitioner had asserted that 38 U.S.C. § 3101 mandated such insurance shall be exempt from taxation. Mr. Justice Black agreed that the *proceeds* were exempt from taxation under the statute *but* he added:

> "An estate tax is not levied upon the property of which an estate is composed. It is an excise imposed

> upon the transfer of or shifting in relationships to property at death . . . [T]he taxing power was . . . exercised upon 'the transfer of property procured through expenditures by the decedent with the purpose, effected at his death, of having it pass to another. . . .'" (307 U.S. at 60)

"Exemptions from taxation do not rest upon implication."

The United States Supreme Court had granted certiorari in *Helvering* because "State courts have differed as to whether proceeds of War Risk Insurance are subject to death duties imposed by States. See, for example, *Re Harris,* 179 Minn. 450, 229 N. W. 78 . . . (holding these proceeds not subject to such excise); and *Re Sabin,* 224 App. Div. 702 (1928), *Re Dean,* 131 Misc. 125, 1927 (contra)." (*U.S.* v. *Helvering, supra,* footnote at 58-59).

The property passing to the United States on the death of the decedent is clearly includible in the gross estate for Federal estate tax purposes since the decedent owned the property at the time of his death. (I.R.C. § 2033)

To hold that property passing by operation of law is not includible in the Federal estate tax would exclude all assets such as jointly held property and insurance payable to named beneficiaries from all estate tax. Yet, these assets are all included without any doubt under I.R.C. § 2033.

The right to impose a New York estate tax on the estate of a deceased veteran (derived from VA benefits) who died intestate, without heirs or next of kin, outside a VA facility which passes to the United States under a comparable escheat statute (38 U.S.C. § 3202[e]) has been sustained in *Matter of O'Brine* 37 N. Y. 2d 81 (1975).

> "Congress intended that the federal estate tax should be paid out of the estate as a whole and that

the applicable law as to the devolution of property at death should govern the distribution of the remainder and the ultimate impact of the federal tax." *Riggs* v. *Del Drago,* 317 U.S. 95, 97-98.

* * *

"The property of a decedent not disposed of by will, after payment of Administration and Federal Expenses, Debts and *Taxes,* shall be distributed . . ." (EPTL 4-1.1). (emphasis added)

In reviewing the Congressional history of the first Federal death tax statute of 1916, in *Riggs,* Mr. Justice Murphy calls attention to the language of then Congressman Cordell Hull, the reputed draftsman, page 98, fn. 4:

"'Under the general law of descent the proposed estate tax would be first taken out of the net estate before distribution . . .' 53 Cong. Rec. 10657."

Legislative History

The legislative history of section 17, the predecessor of section 5220, of Title 38 makes it clear that the Congress intended to permit a state to impose an estate tax on the right of the veteran to transfer property, including that derived from VA benefits.

In discussing H.R. 4692 which was enacted as 55 Stat. 868, c. 634 (Dec. 26, 1941) and contained section 17 of title 38, Congressmen Van Zandt and Rankin made the following statements:

"MR. VAN ZANDT . . . if this bill is enacted into law, the veteran when making application for hospitalization will simply agree to the disposition of his property in case of death and leaves no relatives."

* * *

> "MR. RANKIN* of Mississippi. The only possible conflict that could arise would be between the State and the Federal Government on the grounds that what little he leaves would escheat to the State, . . ." [87 Cong. Rec. 5203 (1941]

Later on in the debate, the following answer was given by Congressman Rankin, the sponsor of the bill, to a question posed by Congressman Elston:

> "MR. ELSTON. Is there anything that might be construed to dispense with the administration of an estate and the payment of taxes?"
>
> * * *
>
> "MR. RANKIN of Mississippi. No; I do not think so, where a veteran makes this agreement when he enters the hospital. If he has much of an estate, he will not go to the hospital. He will take care of himself. But where he goes to the hospital and signs this agreement, of course, when he dies his property is disposed of in the way provided in this bill." (Id.)

The United States Internal Revenue Service concedes that property passing to it is includible in the gross estate for tax purposes.** The then I.R.S. Commissioner Alexander in his letter to the Administrator of Veteran affairs*** stated:

> "A decedent whose property descends under 38 U.S.C. 5220 retains all his interests therein until his

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* *Mr. Rankin* had been serving in Congress for 20 years as of 1941. He was Chairman of the Committee on World War Veterans' Legislation ("Official Congressional Directory" 77th Congress, 2d Session, 2d ed. 5/26/42 at 57, 58).

** Letter dated 4/8/75 from Acting Staff Assistant to Regional Counsel, N.Y. Office Internal Revenue Service to Scott P. Crompton, Assistant Attorney General, Tax Division, Dept. of Justice, Washington, D.C. (Rec. on App.—Doc. #2, Exhibit 3).

*** Rec. on App.—Docket #2, Exhibit 4.

death. His interests do not expire but rather, pass to the United States.

There could be no prior transfer, else the property would not be subject to the statute. Therefore, whatever property passes must be includible in his gross estate under section 2033." (p. 4)

Thus, the assets in question most assuredly are part of decedent's estate for tax purposes.

POINT III

Non-VA derived assets passing to the United States Government pursuant to 38 U.S.C. 5220 are not deductible from the decedent's gross estate.

The Court below in its opinion found incomprehensible the argument asserted by the United States government that the assets passing to it were a proper deduction under section 2053 of the Internal Revenue Code.*

"On April 8, 1975, the Internal Revenue Service ("IRS") ruled that decedent's property vesting in the United States was deductible from decedent's gross estate for federal estate tax purposes pursuant to 28 U.S.C. 2053. The United States maintains that this is the correct result. However, in that this section merely makes state tax law applicable to federal estate taxa-

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* *Internal Revenue Code*

"*Sec. 2053.* Expenses, Indebtedness, and Taxes

(a) *General rule*—For purpose of the tax imposed by section 2001, the value of the taxable statute shall be determined by deducting from the value of the gross estate such amounts—

(1) for funeral expenses,

(2) for administration expenses,

(3) for claims against the estate,

as are allowable by the laws of the jurisdiction . . . under which the estate is being administered."

> tion with respect to certain deductions, the Court fails to see and the Government has made no attempt to explain, how such section is applicable to the case at bar."
>
> (Opinion, p. 4)

The IRS has issued "National Office Technical Advice Memorandum" dated August 20, 1976 which explains the position of the United States regarding the deductibility of 5220(a) assets from the gross estate (Appendix 10a).

This Memorandum, now incorporated in Rev. Rul. 76-542, concluded that property passing to the United States pursuant to 38 U.S.C. § 5220(a) is an allowable deduction under Treas. Reg. § 20.2053-4 "as a liability imposed by law".

This interpretation is incorrect. 38 U.S.C. § 5220(a) is a "custody" escheat and not a true liability imposed by law. The property in question is to be held by the federal government in its custody, in trust, to be held forever available to any heirs who come forward to claim it at any time.

This position is entirely consistent with the one taken by the United States in *Matter of Hammond*, 3 N.Y. 2d 567 at 571, 572 (1958); Veterans' Administration Solicitor's Opinion (84-193) Feb. 5, 1946. A copy of said opinion, Federal Government Brief, pp. 49-52, filed with the Court of Appeals in *Matter of Hammond*, 3 N.Y. 2d 567, 581 is appended hereto. (Appendix 10a).

The New York Court of Appeals agreed with the Solicitor's Opinion and held that the United States, under the veteran's statute in question, does take by custodial escheat.* Therefore, if these assets are merely held in trust, subject to future claim by heirs, they cannot be

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* It is interesting to note that the U.S. Government in its *Hammond* brief at pp. 42, 43 asserts that after escheat these assets remain subject to "after appearing claimants."

deductible as a "liability imposed by law". (Treas. Reg. § 20.253-4).

Furthermore, these assets cannot be deductible as a bequest by a deceased veteran to the United States.

Before a Treas. Reg. § 20.2053-5(b) deduction claim may be allowed as a charitable bequest, a contract has to be established whereby the deceased veteran contracts to bequeath to the United States all his property at his death (not otherwise disposed of).

The vesting provisions of 38 U.S.C. § 5220(a) apply not merely to the *initial* furnishing of care or treatment to the veteran in a VA facility—but "also to the further furnishing of care or treatment. . . ." (38 U.S.C. § 5220[b]). Thus, a new contract is required with each re-admission.

In point of fact this means the Government is claiming property of the veteran $7,066.76, not otherwise disposed of, as vesting immediately on his death, in the United States as trustee for the General Post Fund under 38 U.S.C. § 5220(a). But a deduction for a bequest under Treas. Reg. § 20.2053(b) supposes the decedent signed the application on readmission contracting to leave all his property, not otherwise disposed of, to the United States at his death.

The VA Form 10-10r application for readmission to the VA hospital dated 3-1-73 was never signed by the decedent, hence the contract bequest provided therein never became effective.

Although the property of a decedent-veteran may be immediately vested in the United States on the death of a decedent-veteran under 38 U.S.C. 5220(a) by virtue of the Congressional mandate, the claim for deduction presupposed the existence of a contract wherein the deceased veteran bequeaths his property, not otherwise disposed of to the United States. (Treas. Reg. § 20.2053-5[b]).

The United States cannot justify the deduction as one for medical care and treatment.

If the Federal Government can establish its claims against the estate for medical services rendered decedent in the VA hospital and parenthetically for decedent's property passing to the United States as a bequest pursuant to a contract the decedent-veteran made with the VA at the time of readmission to the hospital on March 1, 1973, then deductions would be allowable under Treas. Reg. §§ 20.2053-5(a) and (b) to the extent of the value of the property vesting in the United States. (SCPA § 1809[3]; 211[1]).

And a refund for the amount of the state estate tax ($84.59) would be available, for the benefit of the Federal Government in the Surrogate's Court. (Tax Law, §§ 249-a [2], 962[b][5]).

However, if a veteran's disability is "war service connected" no deduction claim would be allowable under Treas. Reg. § 20.2053-5(a) because it is the obligation of the Federal Government to furnish a veteran care and treatment for a disability which is "war service connected" without charge (38 U.S.C. 610[a][1]).

No deduction could then be claimed against the estate for medical care treatment since it was not a personal obligation of the decedent. (Treas. Reg. § 20.2053-4).

Therefore, there is no basis to the claim by the United States Government that these 5220(a) assets are deductible from the decedent's gross estate.

POINT IV

The United States District Court, Southern District of New York should not have entertained jurisdiction.

The above proceeding was originally pending in New York State Surrogate's Court, Bronx County. It was removed to the District Court on petition of the Federal Government.

Section 1341 of Title 28 of the United States Code provides:

> "The district court shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."

Therefore, the removal was not proper.

The Court below, in footnote 2 of its decision, concedes that the issue before the District Court is whether or not certain assets are subject to New York estate tax. Clearly, the two conditions of Section 1341 of Title 28 are satisfied —a state tax question is involved and a "plain, speedy and efficient" remedy is available in a state court. Moreover, the state court here, which had original jurisdiction, is one that restricts itself in subject matter to issues involving decedent's estates, and one that deals with the New York estate tax on a daily basis.

The District Court decision relies on *United States* v. *Woodworth,* 170 F. 2d 1019 (2d Cir. 1948) for the proposition that Section 1341 is inapplicable when the United States is a party. Circuit Judge Frank, for this Court, in reference to the statute which is now Section 1341, held:

> "The appellants contend that as this suit was for an injunction restraining the collection of a state tax the district court, because of the last sentence of 28 U.S.C.A. § 41(1) [now § 1341], lacks jurisdiction. We

cannot agree. We think Congress did not intend this statutory provision, added by amendment in 1937, to apply to the United States which was not specifically named therein." (*supra,* p. 1020).

However, in *United States* v. *City of New York,* 175 F. 2d 75 (1949), cert. den. 338 U.S. 885 (1949), Judge Frank, again writing a unanimous opinion for this Court, elaborated on his holding in Woodworth:

> "In *United States* v. *Woodworth,* 2 Cir. 170 F. 2d 1019, we held that 28 U.S.C.A. § 1341 does not bar a suit in the federal courts by the United States to obtain an injunction against the collection of a state or city tax. Accordingly, the district court had jurisdiction of the subject matter. . . .
>
> "*However, the existence of jurisdiction is not enough . . . The question of the validity of a state or municipal tax is one which the state courts are peculiarly fitted to answer and which therefore, a federal court should not consider.* (emphasis supplied)
>
> "It is not denied by the United States that, after the levy of the taxes, a wholly adequate remedy was open to it . . . in the state courts. Whether, because of a delay, that remedy is not now available is not material, for *the United States should never have sought relief in a federal court.*" (*United States* v. *City of New York, supra,* 175 F. 2d at 77) (emphasis supplied)

The District Court's decision goes on to recite the incorrect premise that the New York Estate Tax Law incorporates the federal estate tax law, so the tax question is not state, but federal, and supports that premise by relying on Section 955(a) of the New York State Tax Law (see Relevant Statutes Section). This law does incorporate the federal tax deductions as the New York State Tax deductions, but this is not an absolute rule (see Section 961[a][3] N.Y.S. Tax Law, which holds that a final federal deter-

mination is also determining of N.Y.S. estate tax issues "unless such final federal determination is shown to be erroneous.").

More importantly, 955(a) deals only with deductions, yet Judge Connella states in the "Merits" section of his opinion: "the court fails to see and the Government has made no attempt to explain, how such section is applicable to the case at bar."

The State does not contend that its courts have exclusive jurisdiction in this matter, but the district court should have declined to consider the matter because the issue of interpreting the New York State estate tax is one which the Surrogate's Court is peculiarly fitted to answer.

In *Great Lakes* v. *Huffman,* 319 U.S. 293 (1943), employers sought a declaration that a state unemployment compensation scheme imposing a tax upon them was unconstitutional as applied.

The Supreme Court of the United States held in pertinent part:

> "It is in the public interest that federal courts of equity should exercise their discretionary power to grant or withhold relief so as to avoid needless obstruction of the domestic policy of the States."
>
> 'The scrupulous regard for the rightful independence of state governments which should at all times actuate the federal courts, and a proper reluctance to interfere by injunction with their fiscal operations, require that such relief should be denied in every case where the asserted federal right may be preserved without it. Whenever the question has been presented, *this Court has uniformly held that the mere illegality or unconstitutionality of a state or municipal tax is not in itself a ground for equitable relief in the courts of the United States.* If the remedy at law is plain, adequate and complete,

> the party is left to that remedy in the state courts, from which the case may be brought to this Court for review if any federal question be involved. (*Matthews* v. *Rodgers,* 284 U.S. at pages 525, 526).' *Great Lakes* v. *Huffman, supra,* 319 U.S. at 297, 298.

In a recent Supreme Court case the Court pointed out:

> "A federal district court is under an equitable duty to refrain from interfering with a State's collection of its revenue except in cases where an asserted federal right might otherwise be lost" (*Tully* v. *Griffin,* 429 U.S. 68 [1976], 50 L. ed. 2d 227, 232).

And so, the District Court, both pursuant to Section 1341 of Title 28 and as a matter of equity should not have entertained and retained jurisdiction to determine whether decedent's New York assets were subject to New York State estate tax. The assets involved had their situs in New York. Properly they were the subject, not only of administration by the New York courts, but New York's laws of descent and distribution rendered them the subject of escheat by the State of New York. *Matter of Menschefreund,* 283 App. Div. 463 (1st Dept., 1954), affd. 8 N.Y.2d 1093 (1960), cert. den. *sub nom. Brown* v. *Lefkowitz,* 365 U.S. 842 (1961). See also *Matter of Garwitt,* 41 N.Y.2d 845 (1977).

Conclusion

1. Congress was without power to declare an escheat under 38 U.S.C. § 5220 as to property which was not derived from V.A. benefits.

2. Property passing to the United States under 38 U.S.C. § 5220 is subject to estate tax under Article 26 of the New York tax law.

3. Non-V.A. derived assets passing to the United States government pursuant to 38 U.S.C. 5220 are not deductible from the decedent's gross estate.

4. The United States District Court, Southern District of New York should not have entertained jurisdiction.

Dated: New York, New York
October 26, 1977

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